

**MINUTES
REGULAR MEETING
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, February 20, 2009
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Michael Townsend, Chair of the ASRS Board, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Michael Townsend, Chair
Mr. Dave Byers, Vice-chair
Mr. Chris Harris
Mr. Jaime Gutierrez (via telephone)
Mr. Jim McLaughlin (via telephone)
Dr. Keith Meredith
Mr. Larry Trachtenberg (arrived at 8:41 a.m.)
Mr. Steve Zeman
Mr. Tom Connelly

A quorum was present for the purpose of conducting business.

2. Approval of the Minutes of the December 19, 2008 Regular Session of the ASRS Board

Motion: Mr. Dave Byers moved to approve the minutes of the December 19, 2008, Regular Session of the ASRS Board.

Mr. Steve Zeman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

3. Presentation, Discussion and Appropriate Action Regarding the Arizona State Retirement System's Comprehensive Annual Financial Report (CAFR) for FY 2008

Mr. Cory Arvizu, Partner, and Mr. Neil Galassi, Lead Auditor, of Heinfeld, Meech & Company addressed the Board regarding the ASRS' CAFR. Mr. Arvizu said Heinfeld Meech issued an unqualified Independent Auditor's Report for the fiscal year ending June 30, 2008. The audit performed for the report showed no significant issues with the ASRS financial accounting protocols. Mr. Arvizu expressed appreciation for the cooperation of the ASRS Board and staff during the audit process.

Mr. Galassi gave a synopsis of the audit. He said there were significant communications with the ASRS and all staff members were cooperative and helpful.

Mr. Larry Trachtenberg arrived at 8:41 a.m.

The Board commended ASRS staff for the exemplary audit.

4. Presentation, Discussion and Appropriate Action Regarding the 2009 Legislative Session

Mr. Patrick Klein, Assistant Director, External Affairs Division, and Ms. Lesli Sorensen, Government Relations Officer, addressed the Board regarding the 2009 ASRS legislation. Ms. Sorensen gave a general update highlighting bills of interest. Ms. Sorensen noted the positive responses she had received on the ASRS presentation to the Senate.

Mr. Chuck Foy, CWA, ASEA, stated that he was impressed with the ASRS presentation to the legislative committee. He also addressed the Board regarding the 2009 legislative session. Mr. Foy stated that, on behalf of his organizations, the proposed ASRS legislation regarding amendments and RTW issues is acceptable.

5. Presentation, Discussion and Appropriate Action Regarding the Total Fund Investment Performance for Quarter Ending 12/31/08

Mr. Terry Dennison addressed the Board regarding the ASRS Investment Performance for Period Ending December 31, 2008, highlighting specific areas of interest and concern.

The Total Fund Performance for the period ending December 31, 2008 is:

	Quarter	1 Year	3 Years	5 Years	10 Years	Inception
Total Fund	-14.1%	-26.8%	-3.8%	1.1%	2.3%	9.5%
Benchmark*	-15.0%	-27.4%	-3.6%	1.0%	1.4%	9.3%
Excess Return	0.9%	0.6%	-0.2%	0.1%	0.9%	0.2%

* Interim Benchmark (current): 37% S&P 500, 7% S&P 400, 7% S&P 600, 27% Barclays Capital Aggregate, 19% MSCI ACWI ex US, and 3% NPI+100 bps

Note: Interim Benchmark incorporates a proration of 3% real estate and 5% private equity

Policy History:

- 7/1/75-12/31/79 – 40% S&P 500/60% Barclays Capital Aggregate
- 1/1/80-12/31/83 – 50% S&P 500/50% Barclays Capital Aggregate
- 1/1/84-12/31/91 – 60% S&P 500/40% Barclays Capital Aggregate
- 1/1/92-12/31/94 – 50% S&P 500/40% Barclays Capital Aggregate/10% EAFE
- 1/1/95-6/30/97 – 45% S&P 500/40% Barclays Capital Aggregate/15% EAFE
- 7/1/97-12/31/99 – 50% S&P 500/35% Barclays Capital Aggregate/15% EAFE
- 1/1/00-9/30/03 – 53% S&P 500/30% Barclays Capital Aggregate/17% EAFE
- 10/1/03-12/31/06 – 53% S&P 500/26% Barclays Capital Aggregate/15% MSCI EAFE/ACWI ex US⁽¹⁾/6% NPI+100 bps
- 1/1/07-present – 31% S&P 500/7% S&P 400/7% S&P 600/26% Barclay^s Capital Aggregate/18% MSCI ACWI ex US/6% NPI+100 bps/5% Russell 3000+300 bps

⁽¹⁾ MSCI EAFE/ACWI ex US Benchmark is the MSCI EAFE prior to 10/1/05 and the MSCI ACWI ex US thereafter.

Mr. Byers noted the recent European financial forecast by Mercer Investment Consulting appeared very negative. He asked what action Mercer feels the ASRS should take. Mr. Dennison said ASRS doesn't have allocations to Europe-specific mandates. The Austrian banks are in trouble, the U.S. sub-prime mortgage issues have affected Europe, and there is an exchange rate mortgage issue. He said we may consider finding out what our managers' views are, whether they have invested in European equities and will decrease those allocations. Mr. Dennison said we also may consider reducing the allocation to international investments in general. Latin America and Asia are also suffering. The GDP in Japan is down 12%. The issue is the likely decline in the value of currency.

Mr. Byers said many U.S. Large Capital companies are making a profit in Europe, so we may also need to consider that. Mr. Dennison said if we are invested in a separate account, as opposed to a pooled account, we can express our concerns and open a dialogue with our managers.

Mr. Dokes provided background information and current perspective.

6. Presentation, Discussion and Appropriate Action Regarding the U.S. Equity Asset Class Review

Mr. Gary Dokes, Chief Investment Officer, Mr. Dave Underwood, Portfolio Manager, and Mr. Dennison addressed the Board regarding the U.S. Equity asset class reporting for quarter ending December 31, 2008. Mr. Dokes stated that as of December 31, 2008, the total market value of the ASRS U.S. Equity asset class was \$8.3 billion and represented approximately 42% of the ASRS total fund. The U.S. Equity asset class policy target/range is 45% ($\pm 5\%$). Approximately 72% of the assets are passively managed.

In 2008, the U.S. Equity asset class underperformed the custom Domestic Equity Benchmark by 17 bps. Over the past three years, however, the U.S. Equity asset class has outperformed the custom Domestic Equity Benchmark by 17 bps annually.

7. Presentation, Discussion, and Appropriate Action Regarding ASRS Cash Flow Management

Mr. Matson addressed the Board regarding cash flow and liquidity management. Though the ASRS' liquidity position (relatively liquid investments) is favorable and exceeds existing cash flow requirements, the Director and the CIO recognize that additional cash needs may develop over the short and intermediate term as a result of the existing and likely continuing dislocated financial market environment, retirement demographics, hiring freezes, potential government downsizing and so forth.

To ensure continued liquidity, Mr. Matson said he and the CIO intend to postpone the approval of new commitments to private market investments until at least March 31, 2009, unless an overriding investment opportunity exception exists. This applies to private markets investments with "locked-up" capital investments structures (e.g. general partner (GP)/limited partner (LP) construct) and primarily pertains to private equity, private real estate and opportunistic investment asset classes. This action is viewed as precautionary and preemptive should liquidity issues arise which may hinder funding of private market

investments, inhibit rebalancing, or cause other potential stresses to the Fund. This will be reviewed around March 31, 2009, and will likely be extended through June 30, 2009.

8. Presentation, Discussion, and Appropriate Action Regarding the ASRS Divestment Policy

Mr. Matson addressed the Board regarding the ASRS Divestment Policy. He explained pursuant to §35-392, Arizona Revised Statutes, as added by Laws 2008, Chapter 201, the ASRS is required to adopt a policy regarding investment in companies that do business in or with the countries currently designated by the United States Department of State as State Sponsors of Terrorism. Laws 2008, Chapter 201 also requires submission of this policy to the Legislature.

As required by §35-392, the policy includes the following:

- The procedure to identify United States companies that are in violation of Section 6(j) of the Export Administration Act.
- The process for communicating with the companies and appropriate federal officials regarding actions taken pursuant to the Policy.
- The process for divestment from the companies that are identified.

Mr. Matson said the ASRS has contracted with Institutional Shareholder Services, Inc. a subsidiary of RiskMetrics Group (ISS/RMG) to perform company research and maintain communications as directed by the Policy.

Mr. Matson commented that there are at present no investments from which the ASRS will need to divest as a result of implementing this Policy. He said there are, however, some divestments that may occur as a result of recent Iran and Sudan divestment legislation that is distinct from the Divestment Policy.

9. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Consultant Contracts

Mr. Trachtenberg addressed the Board regarding the investment consulting services contract. During the 4th quarter of 2008, the Investment Consultant Search Evaluation Committee, consisting of the Investment Committee (IC) Trustees, the Director and CIO, evaluated the eight responses to the Request for Proposal (RFP). As a result, five respondents were interviewed and one was selected for possible engagement as the ASRS general consultant. Additionally, four consultants from the RFP response list were selected as possible project consultants.

Motion: Mr. Trachtenberg moved to:

- Award the general investment consultant contract to New England Pension Consulting (NEPC).
- Award project consultant contracts to Strategic Investment Solutions (SIS), Meketa Investment Group, Callan, and Mercer.

Mr. Tom Connelly seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Mr. Harris expressed desire to address governance of the asset class committees at an upcoming IC meeting.

Mr. Matson expressed appreciation for Mercer's many years of service. He stated that the intent was to retain NEPC as soon as practical after the Board Meeting. Mr. Dokes said Mercer would assist with the transition.

10. Presentation, Discussion and Appropriate Action Regarding the Governance Handbook Annual Responsibilities and 2008 Strategic Initiatives Follow Up

Mr. Matson addressed the Board regarding the Annual Responsibilities report. The report details the status of the annual responsibilities laid out in the Governance Handbook for the Board, the Board Committees, and the Director.

Mr. Matson commented on the ASRS 2008 Strategic Initiatives report, which documents the status of the 2008 calendar year Strategic Initiatives. Mr. Matson emphasized the importance of retaining Trustee and Executive focus on strategic issues. He highlighted the Governance Handbook review and revision at the April 18, 2008 Board meeting and the Board Strategic Planning Session, which was held September 19, 2008.

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, addressed the customer service improvements. He also explained the PRIDE Brand of customer service that is being developed to reflect the agency's values and the three areas being addressed: work environment, service culture, and public image.

11. Director's Report

Mr. Matson stated the Internal Audit Division reported no infractions within the Investment Management Division for December 1, 2008 through January 31, 2009.

12. Possible Presentation Regarding Board Committee Updates

Mr. Jaime Gutierrez, Chair, External Affairs Committee (EAC), stated that the next EAC meeting will take place in March 6, 2009, and that legislation will be discussed.

Mr. Larry Trachtenberg, Chair, Investment Committee (IC), stated that the next IC meeting will be March 16, 2009.

Mr. Dave Byers, Chair, Operations Committee (OC), stated that the OC meeting will be on February 26, 2009.

13. Board Requests for Agenda Items

There were no requests for agenda items.

14. Call to the Public

Mr. Dan Hinsley requested the Board consider providing a window for retirees to buy back years of service toward retirement.

15. The next ASRS Regular Board meeting is scheduled for Friday, March 20, 2009, at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

16. Adjournment of the ASRS Board

Mr. Townsend adjourned the February 20, 2009, Board meeting at 11:13 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Lisa Hanneman, Secretary Date

Paul Matson, Director Date